

ANALYSIS OF AMENDED BILL

Author: Haynes Analyst: Colin Stevens Bill Number: SB 1636

Related Bills: SB 1275 (1997) Telephone: 845-3036 Amended Date: 4/1/98

Attorney: Doug Bramhall Sponsor: _____

SUBJECT: Smokemeter Credit

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would allow a credit equal to 6.5% of the taxpayer's gross sales during the year of certain heavy-duty smokemeters manufactured in this state.

SUMMARY OF AMENDMENT

The April 1, 1998, amendments removed the bill's prior provisions relating to certification of smokemeters and inserted the language discussed in this analysis.

EFFECTIVE DATE

This bill would take effect immediately upon enactment and would apply to taxable or income years beginning on or after January 1, 1998.

SPECIFIC FINDINGS

Federal and state laws allow a variety of tax credits and deductions designed to promote or influence specific taxpayer behavior. Neither federal nor state laws specifically allow a tax credit for the gross sales of a heavy-duty smokemeter. However, under both federal and state laws, the cost to produce a smokemeter would be capitalized as inventory and offset against sales as a cost of goods sold.

Existing state law provides a Manufacturer's Investment Credit for the purchase or lease of manufacturing equipment. Existing state law also provides special tax incentives for taxpayers conducting business activities within economic development areas, including enterprise zones (EZs), local agency military revitalization areas (LAMBRAs) and the Los Angeles Revitalization Zone (LARZ) and targeted tax areas (TTA). These economic development area incentives include a sales or use tax credit generally applicable to the purchase of machinery and machinery parts.

DEPARTMENTS THAT MAY BE AFFECTED:

___ STATE MANDATE

___ GOVERNOR'S APPOINTMENT

Board Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
___ X ___ PENDING

Agency Secretary Position:

___ S ___ O
___ SA ___ OUA
___ N ___ NP
___ NA ___ NAR
DEFER TO _____

GOVERNOR'S OFFICE USE

Position Approved ___
Position Disapproved ___
Position Noted ___

Department/Legislative Director Date

Gerald H. Goldberg 4/13/98

Agency Secretary Date

By: Date:

Under the PITL and the B&CTL, **this bill** would allow a credit equal to 6.5% of a taxpayer's gross sales during the year of any heavy duty smokemeters manufactured by the taxpayer in California that have been approved for use by the California Air Resources Board (CARB).

Since **this bill** does not specify otherwise, the general rules in income tax law regarding the division of credits among taxpayers who share in the costs would apply. This credit would not reduce regular tax below tentative minimum tax for alternative minimum tax purposes.

Policy Considerations

Most credits are allowed based on a percentage of a cost paid or incurred (i.e., provide an incentive to help defray actual costs). However, this credit would be allowed based on the "gross sales" (income) by a taxpayer and bears no relationship to actual expenses.

This bill grants a credit based on gross sales, but conditions that credit by requiring the taxpayer to manufacture smokemeters in California. The result may be viewed as an indirect subsidy to local (California) business which discriminates against interstate commerce. As such, it may be subject to constitutional challenge under the Commerce Clause of the United States Constitution.

It is unclear whether the author intends that this bill require that a taxpayer manufacture smokemeters entirely in California in order to receive a credit or whether a smokemeter assembled in California from parts made outside of California could qualify for credit. As written, the California manufacturer might only assemble parts made outside California or outside the United States and receive a credit based on the sales price.

Although this bill would require that a smokemeter be approved for use by the CARB, it would not require that the smokemeter adhere to the most recent CARB requirements. Therefore, it is unclear whether a taxpayer could receive a credit for sales of smokemeters in other states that may no longer be used in California.

Most credits contain a sunset date so the Legislature may review their effectiveness. This bill does not contain a sunset date.

Implementation Considerations

The term "gross sales" is not defined. Since this term is not generally used in income tax law, a definition should be provided to ensure that disputes do not arise between taxpayers claiming the credit and the department as to what amount can be claimed for the credit.

Technical Consideration

The author's staff has indicated that the bill is intended to allow a credit for gross sales of smokemeters used to measure emissions from heavy duty trucks. However, the bill uses the undefined term "heavy duty smokemeters," which may be misleading since it could refer to a heavy duty

piece of equipment designed to test smoke on any vehicle. A better description may be of a smokemeter used for testing heavy duty vehicles.

FISCAL IMPACT

Departmental Costs

This bill is not expected to significantly impact the department's costs if the implementation concerns addressed in this analysis are resolved.

Tax Revenue Estimate

The maximum impact under the B&CTL is given below. Due to disclosure constraints (discussed below), the department is not able to provide applied credits against available tax liabilities.

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 1997 Enactment Assumed After June 30, 1998 \$ Millions		
1998-9	1999-00	2000-01
(minor*)	(minor*)	(minor*)

* Loss of \$500,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact for this bill would be determined by the number of taxpayers that manufacture qualified smokemeters in California, the sales price, the number of units sold, and the average amount of credits that can be applied against available tax liabilities.

This estimate was developed in the following steps. First, according to CARB, currently only two companies in California manufacture a smokemeter that meets the prescribed standards of SAE J1667, currently required by CARB for smokemeters. Second, according to the same unit, the total number of smokemeters that may be sold is approximately 1,500 for 1998. Third, the average price of a smokemeter is \$5,000 with a useful life of five years. Fourth, the total number of smokemeters sold was multiplied by the average price. Thus, the total sales would be approximately \$7.5 million for 1998 (1,500 x \$5,000). Fifth, the credit amount was calculated at 6.5%, generating maximum credits of \$500,000 for 1998 (\$7,500,000 x 6.5%). Sixth, the average price was increased 5% per year to reflect the increase in costs of smokemeters. Because there are only two companies involved, the department is unable to disclose the amount of credit that could be applied.

BOARD POSITION

Pending.